Nordic Credit Rating

SECTOR COMMENT

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Norwegian mid-size savings banks maintain growth in a competitive market

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Interest rates on lending and deposit products offered by Norwegian savings banks have risen dramatically over the past two years, in tandem with the central bank's policy rate and the Norwegian inter-bank offered rate (NIBOR), which have both increased by about 375bps since the beginning of 2022. We expect another interest rate rise of 25bps before end-2023. To date, the country's banks' earnings have benefited from the successive interest rate rises and have so far managed to avoid significant increases in credit losses. However, opportunities to achieve organic growth are declining amid increasing competition in the sector.

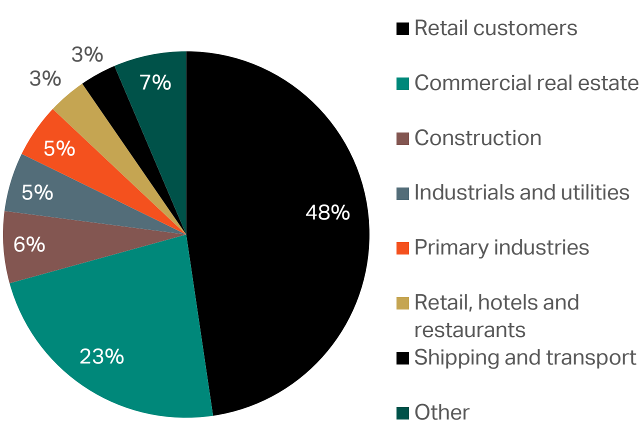
In Norway, mid-size savings banks' lending and deposit rates are more heavily oriented towards retail mortgage lending and local corporate lending than those of the wider domestic banking sector. We looked at a sample of 10 mid-size savings banks (see Figure 2) which had a weighted lending growth of 4.8% in the year ending 30 Sep. 2023, when mortgage loans transferred to commonly-owned mortgage companies are included. This is similar to the 4.9% growth of lending to corporates and households found in the same period across the wider banking sector.

Among our sample, the weighted growth of deposit funding was 4.3% in the year ending 30 Sep. 2023, compared with a decline of 2.2% in deposits placed in the same period by corporates and households nationally. In our view, this suggests that local savings banks have a competitive advantage over larger banks in terms of maintaining organic and stable deposit growth in times of economic flux.

BANK LENDING DOMINATED BY LOW-RISK RETAIL MORTGAGE LENDING

Norwegian banks generally have significant exposure to residential real estate, with retail mortgages accounting for 48% of retail and corporate lending. Among our sample of mid-size savings banks, the concentration is even greater, with retail lending accounting for 71% of total lending. When transferred mortgages are also included, the average is 77%. Of the banks in our sample, Sandnes Sparebank and Fana Sparebank own their own mortgage companies and consolidate transferred mortgage loans on their respective balance sheets. In addition, mid-size savings banks have high levels of exposure to local and regional real-estate markets. This leads to material exposure to housing price fluctuations even though housing price growth over the past decade has strengthened collateral across the wider banking sector.

Figure 1. Norwegian total lending by segment, Q3 2023



Source: Statistics Norway.

Figure 2. Norwegian mid-size savings banks total lending by segment, including transferred loans, Q3 2023

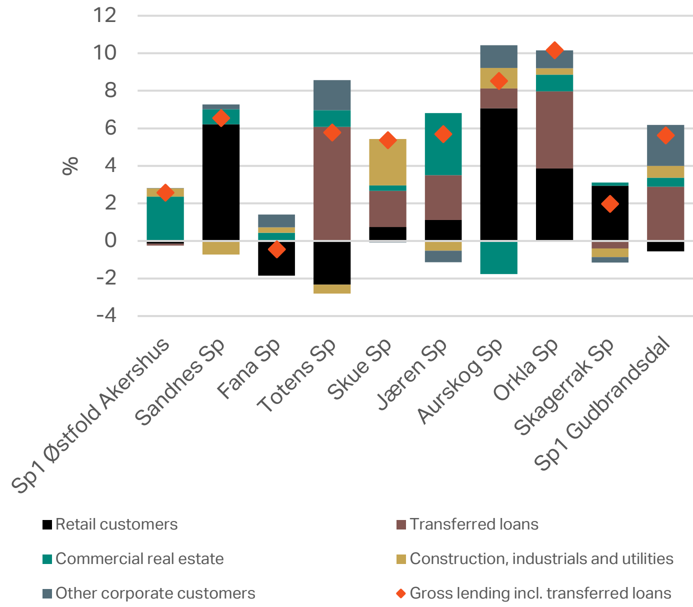
Source: bank reports. *Loans transferred to Sandnes Sp and Fana Sp are consolidated on the banks' respective balance sheets.

Annual growth rates in the wider Norwegian banking sector fell to 4.9% in the third quarter, ending a period of relatively high loan growth. This was driven primarily by corporate and commercial real estate lending as rising interest rates and a lack of risk appetite led to higher financing costs in the capital markets. Among the banks in our sample, average growth of 4.8%, including transferred loans, fell marginally behind growth levels in the wider banking sector, with material variations among individual banks. Aurskog Sparebank, Orkla Sparebank and Sandnes Sparebank saw strong retail growth, both on and off their respective balance sheets. Totens Sparebank reduced its own retail mortgage volumes and pursued growth primarily through transfers to commonly owned credit company Eika Boligkreditt AS. Among the banks in our sample, retail lending and mortgage transfers drove 3.5% of total lending growth over the last four quarters.

Figure 3. Norwegian banks weighted annual lending growth, 2020-September 2023

Source: Statistics Norway.

Figure 4. Norwegian mid-size savings banks weighted annual lending growth, including transferred loans, 12 months to September 2023



Source: bank reports.

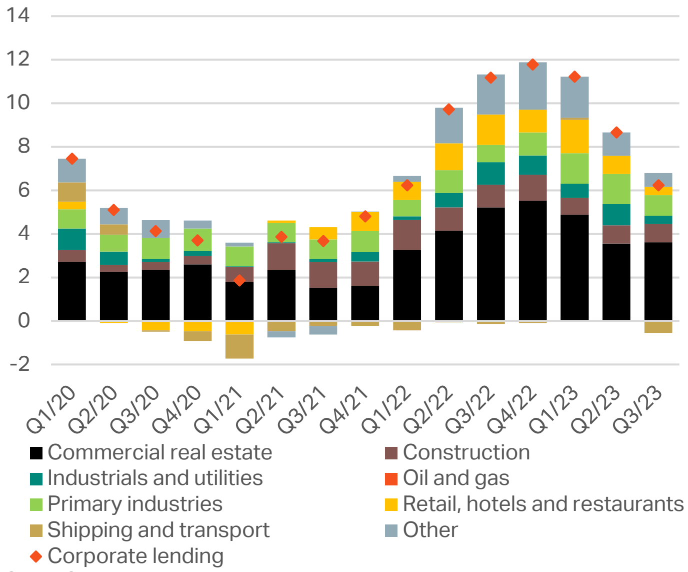
CORPORATE BORROWERS WITH HEIGHTENED RISK ACCOUNT FOR SIGNIFICANT LENDING

In addition to retail mortgage lending, Norwegian banks generally have significant exposure to commercial real estate (26% of on-balance sheet lending). The mid-size savings banks in our sample are located outside major metropolitan areas where property valuations drive even higher levels of lending, though individual exposure rates vary widely. Commercial real estate accounts for 49% of corporate lending across the 10 banks in our sample. Over the past year, loan growth has been 6% in the wider banking sector, but 9% across the sample (10-year national average 6%). Recently, commercial real estate companies have increased the proportion of funding they source through traditional banks. We see a risk that property values will continue to fall in 2024, which could in turn reduce the value of collateral held on savings banks' loan books. However, short-term inflation-linked rental contracts are likely to offset some of the yield compression seen in commercial property valuations so far in 2023 while improved rental cash flows reduce the risk that savings banks will have to increase their loan-loss provisions.

Among the 10 banks in our sample, lending to the construction, industrials and utilities segments has averaged only 4.5% over the year ending 30 Sep. 2023, compared with an average of 5.5% in the wider banking sector (which is just below the 10-year sector average of 6.3%). We believe that the lower growth across our sample reflects reduced transaction activity and lower levels of investment. Higher required rates of return have resulted in delayed building projects, and increased redundancies across the construction sector. We expect an increase in loan-loss provisions and a decline in lending to the construction sector in 2024 amid only moderate levels of building activity.

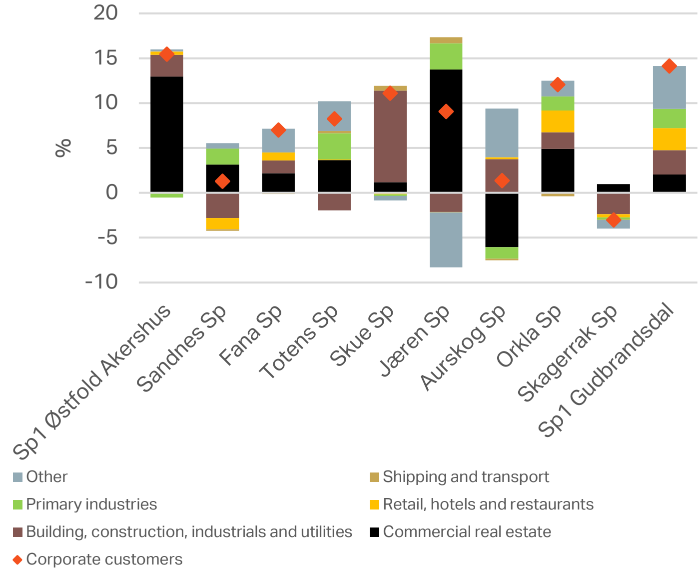
Non-real-estate-related corporate lending varies significantly across our sample, both in terms of lending to specific sectors and overall lending. Location plays a significant role in the corporate lending profiles of savings banks, which have unique commitments to support industry in their respective regions of operation. Among several banks in the sample, lending to the agricultural and primary industrial sectors has supported corporate loan growth over the last year.

Figure 5. Norwegian savings banks weighted annual corporate lending growth, 2020-September 2023



Source: Statistics Norway.

Figure 6. Norwegian mid-size savings banks weighted annual corporate lending growth, 12 months to September 2023



Source: bank reports.

COMPETITION FOR DEPOSIT FUNDING INCREASING

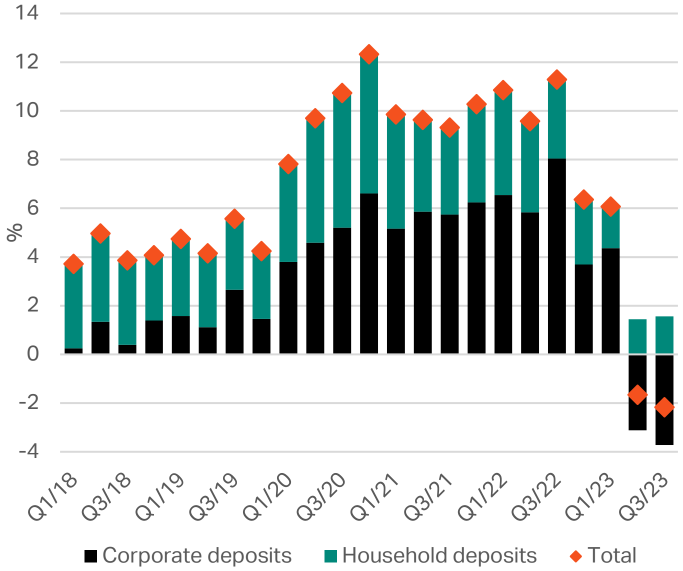
Norwegian savings banks are primarily financed through customer deposits, with the largest proportion coming from local households. This has been an inexpensive funding source in recent years, and the recent sharp rise in interest rates has enabled higher levels of earnings and accumulation of capital as lending rates have outstripped deposits and driven material increases in net margins. However, increased living and interest costs have resulted in lower lending growth and savings rates and intensified competition between banks for stagnating volumes of customer deposits. In addition, higher capital market financing costs have increased the attractiveness of deposits as a financing source.

As of September 2023, Norwegian banks' household deposits accounted for 34% of the total deposit base, while corporate deposits amounted to 23%. Household deposit growth fell to 2.8% in the year to September 2023 from 5.5% in the previous year (10-year average 6.1%). Corporate deposit volumes fell sharply by 8.5% in the year to September 2023 after an abnormally sharp growth of 19.9% in the year to September 2022 (10-year average 7.8%). A further decline in deposits could restrict growth opportunities and earnings, and indirectly worsen capitalisation and loss performance.

Among our sample of mid-size savings banks, annual weighted deposit growth remains positive and above the national banking sector average (4.3% in the third quarter), albeit with significant variations. Retail deposits grew by an annual weighted 5.6% with a strong impact on overall deposit growth as they account for 65% of total deposits. We view the position of the savings banks in their respective local communities as an important factor in their higher rate of deposit growth. In our view, this attracts local customers and promotes customer loyalty, which could prove beneficial in terms of lessening competitive pressure on deposit margins. Orkla Sparebank has increased its focus on deposit funding and introduced a new NIBOR-linked deposit product after a lengthy period of low deposit growth relative to lending growth. This led to retail deposit growth of 31.1% over the last year compared with total deposit growth 17.8% in the same period.

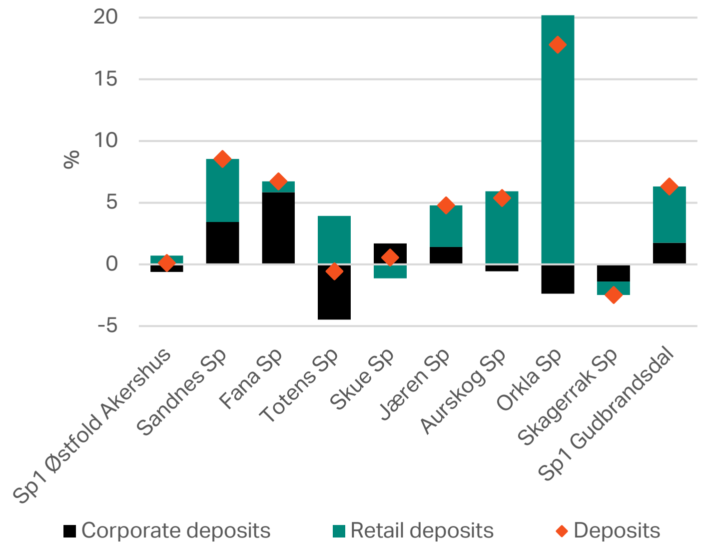
Corporate deposit growth at savings banks remained stable at 2% over the last year, unlike corporate deposits in the wider banking sector, which fell in the same period. Fana Sparebank in particular has seen significant corporate deposit growth in the past year (5.8%), but this could be due to large single-name deposits.

Figure 7. Norwegian savings banks weighted annual deposit growth, 2018-September 2023



Source: Statistics Norway.

Figure 8. Norwegian mid-size savings banks weighted annual deposit growth, 12 months to September 2023



Source: bank reports.

NCR-RATED NORWEGIAN SAVINGS BANKS

Figure 9. NCR ratings on Norwegian savings banks

	SpareBank 1 Østfold Akershus	Jæren Sparebank	Skue Sparebank	Orkla Sparebank	Kredittforeningen for Sparebanker
Long-term issuer rating	A	A-	A-	A-	A-
Outlook	Stable	Stable	Stable	Stable	Stable
Subfactors:					
Operating environment (20%)	a	a-	a-	a-	a-
Risk appetite (50%)	a	a	a	a	a
Competitive position (15%)	bbb+	bbb-	bb+	bb+	bb-
Performance indicators (15%)	a+	a	a	a-	bbb+

See NCR company reports for details.

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